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## Profitability Analysis (A Case Study of Selected Public and Private Sector Companies)

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### ABSTRACT

*Profit is regarded as the soul of the business, without it, the business is lifeless. As a matter of fact, profit is a magic eye that mirrors all aspects of entire business operations including-the quality of output. In the present study it has been hypothesized that there is no significant difference in the profitability of the companies under study. Moreover, the year-wise difference in the profitability of the companies under study is also not significant. The results of the study conclude that significant difference in profitability exists between the companies and overall performance of public companies is better.*

### Keywords :

#### Meaning and Concept of Profit:

Profit is regarded as the soul of the business, without it, the business is lifeless. As a matter of fact, profit is a magic eye that mirrors all aspects of entire business operations including-the quality of output. The profit of a concern influences not only the proprietors but also its managers, directors, tax authorities etc. In the words of Smith (1990) "The term 'profit' carries a variety of meanings not only in technical sense but in interpretative sense as well.

Profit is the figure in absolute terms. It is the number that sits at the bottom of the statement of financial performance. It is calculated by taking the income earned and deducting the expenses incurred in deriving that income. Profit is the ultimate output of a company and it will have no future, if it fails to make sufficient profits. Thus, profit is an indicator of the efficiency with which the operations of the business are carried out.

To the management profits are the test of efficiency and a measure of control to owners, a measure of worth of their investment, to the creditors, the margin of safety, to employees a source of fringe benefits, to government a measure of taxpaying capacity and the basis of legislative action; to customers a hint of demand for price cuts; to an enterprise, less cumbersome source of finance and growth and existence and finally to the country, profits are an index of economic progress, national income, generated and rise in standard of living of the people. Therefore, a business organization can discharge its obligations to the various segments of the society only through profits. Profits are thus, useful intermediate beacon towards which a firm's capital should be directed.

#### Meaning and Concept of Profitability:

The word 'profitability' has been composed of two words 'profit' and 'ability'. The concept of profitability may be defined as the ability of a given investment to earn a return from its use. The profit is not simply the increase in cash made available from business activities but includes some value (positive or negative) arising from the changes in resources commended during the period. The word ability reflects the power of the enterprise to earn the profit. The ability is also referred to as the earning power or operating capacity of the concerned investment. The word 'ability' attached to profit means the earning power or operating performance. The state of profitability is not a condition that exists and can be measured for limited period of time only. It is variable like the temperature of the body.

#### Hypothesis of the Study:

In the present study it has been hypothesized that there is no significant difference in the profitability of the companies

under study. Moreover, the year-wise difference in the profitability of the companies under study is also not significant.

#### Methodology of the Study:

To conduct the present study secondary data have been used. All the figures have been collected from published annual reports and accounts. For this purpose three companies of public sector and three companies of private sector have been taken. The companies of public sector are Bharat Heavy Electricals Limited (BHEL), Steel Authority of India Limited (SAIL), and Shipping Corporation of India (SCI). The companies of private sector are Larsen and Toubro (L&T), Tata Iron and Steel Company Limited (TISCO) and Essar Shipping Ports and Logistics Limited (ESPLL). The figures have been redrafted in the form of 'Common -Size Income Statement' which has been used to analyze the profitability. Analysis has been made by using the technique of ratio analysis and hypothesis has been tested by applying F Test. Statistical techniques such as average, standard deviation and coefficient of variation have also been used to interpret the data.

#### Analysis of Profitability of the Companies under Study

##### 1. Net Profit Ratio

Net Profit Ratio establishes relationship of net profit and net sales of a firm. The net profit margin is indicative of management's ability to operate the business with sufficient success not only to recover from revenues of the period, the cost of merchandise or service, the expenses of operating the business and the cost of borrowed funds, but also to leave a margin of reasonable compensation to the owners for providing their capital at risk. Higher the ratio of net profit to sales better is the operational efficiency of the concern. The Net Profit Ratio in present study has been calculated by using the following formula-

$$\text{Net Profit Ratio} = \frac{\text{Net Profit After Tax}}{\text{Net Sales}} \times 100$$

This ratio is used to measure the overall profitability and hence it is very useful to proprietors. In the present study net profit before interest and tax has been taken into consideration to calculate this ratio. It is an index of efficiency and profitability when used with gross profit ratio and operating ratio.

#### Table 1

**Net Profit Ratio of The Selected Companies under Study**  
(From 2005-06 to 2009-10)

**(Ratio in Percentage)**

Year	BHEL	SAIL	SCI	L&T	TISCO	ESPLL
2005-06	19.15	22.22	31.42	9.47	35.39	32.51
2006-07	21.92	28.80	27.20	11.93	36.67	23.00
2007-08	23.14	29.66	23.75	13.18	39.22	46.19
2008-09	18.57	22.35	27.47	12.94	34.83	24.16
2009-10	20.14	25.98	13.53	17.41	34.86	29.93
<b>Average</b>	<b>20.58</b>	<b>25.80</b>	<b>24.67</b>	<b>12.99</b>	<b>36.19</b>	<b>31.16</b>
<b>S. D.</b>	<b>1.71</b>	<b>3.12</b>	<b>6.08</b>	<b>2.57</b>	<b>1.65</b>	<b>8.30</b>
<b>C.V. (%)</b>	<b>8.31</b>	<b>12.10</b>	<b>24.63</b>	<b>19.81</b>	<b>4.57</b>	<b>26.65</b>

Source: Annual Reports & Accounts of the Companies under study for the period from 2005-06 to 2009-10  
It can be visualized from the Table 1 that the average of net profit ratio was highest in TISCO at 36.19 percent followed by 31.16 percent in ESPLL, 25.80 percent in SAIL, 24.67 percent in SCI, 20.58 percent in BHEL and 12.99 percent in L&T. For all the companies the performance of net profit ratio can be regarded satisfactory but not for L&T. The management of L&T should try to increase the net profit ratio by increasing the net profit and it is only possible when the management tries to control the indirect expenses. All the public sector companies are better placed for the net profit ratio. But in private sector the performance of TISCO and ESPLL is very good even better than public sector. Fluctuations were highest in ESPLL followed by SCI and L&T. The management of these companies should try to keep the fluctuations under control but for other companies the net profit ratio so that consistent trend and the management should try to maintain this position in future also.

**F Test for Net Profit Ratio****(i) F test Between the Companies**

F = Higher Variance / Smaller Variance

F = 327.49 / 25.46 = 12.86

V1=5: V2=20: and table value of F at 5% level of significance = 2.71

Null hypothesis is rejected because the calculated value of F is more than the table value, hence it can be concluded that the difference in the net profit of the companies under study is significant.

**(ii) F Test Within the Years:**

F = Higher Variance / Smaller Variance

F = 32.61 / 25.46 = 1.28

Table value of F at 5% level of significance for V1=4 and V2=20 is 2.87

The Null hypothesis is accepted and it is concluded that the year-wise difference in the net profit of the companies under study is not significant

**2. Return on Investment Ratio**

The return on investment is also known as return on shareholders equity. This ratio indicates the profitability from the shareholders point of view. The return on investment ratio can be calculated by using the following formula

$$ROI = \left[ \frac{\text{Profit after Tax}}{\text{Net Worth}} \right] * 100$$

The term profit after tax means net income after payment of interest and tax including net non-operating income (i.e. non operating income minus non-operating expenses). It is the final income that is available for distribution as dividends to shareholders. Net worth or shareholders funds include both preference and equity share capital and all reserves and surplus belonging shareholders minus fictitious assets.

**Table 2****Return on Investment Ratio of The Selected Companies under Study****REFERENCES**

Jain, S. C. (2003). Performance Appraisal: Raj Publishing House, Jaipur. | Smith, R. L. (1992). Management Accounting: New Prentice Hall, New Jersey. | Chandra, P (2002). Financial Management: Tata McGraw Hill Publishing Company Limited, (5 Ed.), New Delhi | Keown and Martin (2003). Financial Management: Prentice Hall of India, New Delhi | Levin and Rubin (1994). Statistics for Management: Prentice Hall of India, (5 Ed.), New Delhi

**(From 2005-06 to 2009-10)****(Ratio in Percentage)**

Year	BHEL	SAIL	SCI	L&T	TISCO	ESPLL
2005-06	22.10	32.14	23.93	20.41	32.20	8.04
2006-07	27.48	35.73	19.89	24.36	28.15	5.57
2007-08	26.54	32.44	14.45	22.75	16.61	7.87
2008-09	24.25	21.69	15.15	21.74	17.59	1.50
2009-10	27.08	20.02	5.95	23.15	20.28	1.24
<b>Average</b>	<b>25.49</b>	<b>28.40</b>	<b>15.87</b>	<b>22.48</b>	<b>22.97</b>	<b>4.84</b>
<b>S. D.</b>	<b>2.03</b>	<b>6.31</b>	<b>6.04</b>	<b>1.34</b>	<b>6.14</b>	<b>2.97</b>
<b>C.V. (%)</b>	<b>7.97</b>	<b>22.23</b>	<b>38.06</b>	<b>5.94</b>	<b>26.73</b>	<b>61.34</b>

Source: Annual Reports & Accounts of the Companies under study for the period from 2005-06 to 2009-10

The inter-firm comparison of return of investment ratio among the companies under study shown in Table 2 revealed that SAIL was at No. 1 because the average return on investment was 28.40 percent. Year wise also SAIL was ranking first in the return on investment ratio. This situation was followed by BHEL, TISCO, L&T, SCI and ESPLL. The performance of SAIL, BHEL, TISCO and L&T can be regarded satisfactory but the performance of ESPLL was below average which indicates that the management was not properly using the available resources. It can be suggested that the management of ESPLL should try to explore the possibilities of increasing the profitability by making an appropriate use of the available resources.

The fluctuations in the return on investment ratio were highest in ESPLL followed by SCI, TISCO and SAIL. The management should try to control and reduce the fluctuation. The return on investment ratio in BHEL and L&T showed a consistent trend and the management should try to maintain it in future also.

**F Test for Return on Investment Ratio: -****(i) F test Between the Companies**

F = Higher Variance / Smaller Variance

= 362.45 / 18.53 = 19.46

V1=5: V2=20: Table value of F at 5% level of significance = 2.71

Null hypothesis is rejected because the calculated value of F is more than the table value and it can be concluded that the difference in the return on investment ratio of the companies under study is significant.

**(ii) F Test Within the Years:**

F = Higher Variance / Smaller Variance

= 67.77 / 18.63 = 3.64

V1=4: V2=20: table value of F at 5% level of significance = 2.87

The calculated value of F is more than the table value, therefore, the null hypothesis is rejected and it is said that the year-wise difference in the return on investment ratio of the companies under study is significant.

**Conclusion:**

Statistical analysis shows that there are significant differences in the profitability of companies taken in this study. There is significant difference between the companies on the dimensions Net Profit ratio and Return on Investment ratio. But, within year analysis, significant difference exists only on Return on Investment ratio. Overall public sector organizations have performed better in this study.



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